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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

PLUMBERS & PIPEFITTERS LOCAL 572 PENSION FUND, On Behalf of Itself and All Others Similarly Situated,	No.
Plaintiff,	CLASS ACTION
vs.	COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS
CISCO SYSTEMS, INC., JOHN T. CHAMBERS, LARRY R. CARTER, GARY J. DAICHENDT, JUDITH L. ESTRIN, CHARLES H. GIANCARLO, MARIO MAZZOLA, CARL REDFIELD, MICHELANGELO VOLPI, CAROL A. BARTZ, JAMES F. GIBBONS, STEVEN M. WEST, EDWARD R. KOZEL and ROBERT L. PUETTE,	
Defendants.	DEMAND FOR JURY TRIAL

SUMMARY OF THE ACTION

1. This is a securities fraud class action on behalf of persons who purchased Cisco Systems, Inc. ("Cisco" or the "Company") common stock between 8/10/99 and 2/6/01 (the "Class Period"), against Cisco and its top officers and directors for violations of the federal securities laws arising out of defendants' dissemination of false and misleading information concerning the Company's products, financial results and its prospects for fiscal 2001[1] ("F01"), fiscal 2002 ("F02") and beyond.

2. Cisco and its subsidiaries are engaged in selling products for networking for the Internet. By the beginning of the Class Period in 8/99, Internet Service Providers and competitive local telephone companies had technology to deploy but little capital, and Cisco used this as an opportunity to increase its sales by providing capital financing to such companies but making such financing conditional upon the purchase of large amounts of Cisco product. Through this manipulation and the shipment of defective or incomplete products, as well as Cisco's failure to adequately accrue for excess and overvalued inventory and uncollectible finance receivables, Cisco was able to report "record" earnings each quarter during the Class Period. Defendants thus made positive but false statements about Cisco's products, financial results and business during the Class Period. As a result, Cisco's stock traded as high as $82.[2]

3. The inflation in Cisco's stock price was essential to its main corporate strategy – that of growth through acquisition, which Cisco accomplished through the exchange of inflated Cisco shares. In addition, each of the defendants had the motive and the opportunity to perpetrate the fraudulent scheme and course of business described herein in order to sell $595 million worth of their own Cisco shares at prices as high as $80.24 per share, or 84% higher than the price to which Cisco shares dropped after the end of the Class Period, as the true state of Cisco's business and prospects began to reach the market.

4. After completing more than 20 major acquisitions between 9/99 and 2/01, by issuing more than 400 million shares of Cisco stock, and selling more than 10 million shares of their personal Cisco holdings, on 2/6/01, Cisco announced extremely disappointing 2ndQ F01 results, including EPS of only $0.18. This disclosure shocked the market, causing Cisco's stock to decline to less than $30 per share before closing at $31-1/16 per share on 2/7/01, on record volume of more than 279 million shares, inflicting

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[1] Cisco's fiscal year ends on the last Saturday in July.

[2] Unless otherwise noted, all share and per-share amounts reflect a 2-for-1 stock split in 3/00.

billions of dollars of damage on plaintiff and the Class. Cisco later admitted that 3rdQ F01 sales would be less than $4.8 billion, or lower than any quarter since the 2ndQ F00. Defendants' misconduct has wiped out over ***$400 billion*** in market capitalization as Cisco stock has fallen 84% from its Class Period high of $82 per share as the truth about Cisco, its operations and prospects began to reach the market. On 4/16/01, Cisco announced a $2.5 billion write-down of inventory (or 90% of its inventory as of 1/31/01) of components in its service business. This was one of the largest inventory write-downs in the history of the world. The stock has dropped to as low as $13-3/16.

JURISDICTION AND VENUE

5. The claims asserted herein arise under §§10(b) and 20(a) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. §§78j(b) and 78t(a), and Rule 10b-5. Jurisdiction is conferred by §27 of the 1934 Act, 15 U.S.C. §78aa.

6. Venue is proper here pursuant to §27 of the 1934 Act. Acts and transactions giving rise to the violations of law complained of occurred here.

THE PARTIES

7. Plaintiff Plumbers & Pipefitters Local 572 Pension Fund purchased shares of Cisco common stock as detailed in the attached certification and was damaged thereby.

8. Defendant Cisco maintains its headquarters at San Jose, California. Cisco develops and markets networking products for the Internet. Cisco has approximately 7.3 billion shares of common stock outstanding, which shares trade in an efficient market on the NASDAQ National Market System.

9. (a) Defendant John T. Chambers ("Chambers") was, during the Class Period, President, Chief Executive Officer, and a director of the Company. During the Class Period, while in possession of confidential Cisco information, Chambers sold 2.3 million shares of Cisco stock at an artificially inflated price of $65.875 per share, for proceeds of more than $151.5 million.

(b) Defendant Larry R. Carter ("Carter") was, during the Class Period, Senior Vice President-Finance and Administration, Chief Financial Officer, Secretary and director of the Company. During the Class Period, while in possession of confidential Cisco information, Carter sold 2,634,400 shares of Cisco stock at artificially inflated prices as high as $64 per share, for proceeds of more than $99.4 million.

(c) Defendant Gary J. Daichendt ("Daichendt") was, during the Class Period, Executive Vice President-Worldwide Operations of the Company. During the Class Period, while in possession of confidential Cisco information, Daichendt sold 2,216,866 shares of Cisco stock at artificially inflated prices as high as $66-1/2 per share, for proceeds of more than $109.6 million.

(d) Defendant Charles H. Giancarlo ("Giancarlo") was, during the Class Period, Senior Vice President-Small/Medium Business Line of Business of the Company. During the Class Period, while in possession of confidential Cisco information, Giancarlo sold 200,000 shares of Cisco stock at an artificially inflated price of $63.50 per share, for proceeds of more than $12.7 million.

(e) Defendant Mario Mazzola ("Mazzola") was, during the Class Period, Senior Vice President-Enterprise Line of Business of the Company. During the Class Period, while in possession of confidential Cisco information, Mazzola sold 140,624 shares of Cisco stock at artificially inflated prices as high as $64.71 per share, for proceeds of more than $9.1 million.

(f) Defendant Carl Redfield ("Redfield") was, during the Class Period, Senior Vice President-Manufacturing and Logistics of the Company. During the Class Period, while in possession of confidential Cisco information, defendant Redfield sold 1,110,000 shares of Cisco stock at artificially inflated prices as high as $64.81 per share, for proceeds of more than $61.7 million.

(g) Defendant Michaelangelo Volpi ("Volpi") was, during the Class Period, Senior Vice President-Chief Strategy Officer of the Company. During the Class Period, while in possession of confidential Cisco information, Volpi sold 390,000 shares of Cisco stock at artificially inflated prices as high as $64.50 per share, for proceeds of more than $23.3 million.

(h) Defendant Judith L. Estrin ("Estrin") was, during the Class Period, Chief Technology Officer of the Company until her resignation in 4/00. During the Class Period, while in possession of confidential Cisco information, Estrin sold 462,813 shares of Cisco stock at artificially inflated prices as high as $65.89 per share, for proceeds of more than $48.4 million.

(i) Defendant Carol A. Bartz ("Bartz") was, during the Class Period, a director of the Company and a member of the Board's Acquisition and Special Acquisition Committees. During the Class Period, while in possession of confidential Cisco information, Bartz sold 60,400 shares of Cisco stock at artificially inflated prices as high as $64.13 per share, for proceeds of more than $2.5 million.

(j) Defendant James F. Gibbons ("Gibbons") was, during the Class Period, a director of the Company. During the Class Period, while in possession of confidential Cisco information, Gibbons sold 140,000 shares of Cisco stock at artificially inflated prices as high as $63.59 per share, for proceeds of more than $7.3 million.

(k) Defendant Steven M. West ("West") was, during the Class Period, a director of the Company and a member of the Board's Audit Committee. During the Class Period, while in possession of confidential Cisco information, West sold 170,000 shares of Cisco stock at artificially inflated prices as high as $65.78 per share, for proceeds of more than $10.9 million.

(l) Defendant Edward R. Kozel ("Kozel") was, during the Class Period, a director of the Company. During the Class Period, while in possession of confidential Cisco information, Kozel sold 832,000 shares of Cisco stock at artificially inflated prices as high as $64.75 per share, for proceeds of more than $44.5 million.

(m) Defendant Robert L. Puette ("Puette") was, during the Class Period, a director of the Company. During the Class Period, while in possession of confidential Cisco information, Puette sold 190,000 shares of Cisco stock at artificially inflated prices as high as $80.24 per share, for proceeds of more than $14.1 million.

10. The parties listed in ¶9(a)-(m) are referred to as the "Individual Defendants." They are liable for the false statements pleaded herein at ¶¶32-33, 35, 42, 45 and 53, as those statements were each "group-published" information for which they were collectively responsible. Chambers, by reason of his stock ownership and position with Cisco, was a controlling person of Cisco. Cisco controlled each of the Individual Defendants. These controlling persons are liable under §20(a) of the 1934 Act.

SCIENTER, SCHEME AND FRAUDULENT COURSE OF BUSINESS

11. Cisco and the Individual Defendants made false and misleading statements, engaged in a scheme to defraud, pursued a course of business that operated as a fraud and deceit on purchasers of Cisco common stock and sold their Cisco shares while in possession of material negative non-public information regarding Cisco, without disclosing the same.

Cisco's Senior Executives

12. The top executives of Cisco run the Company as "hands-on" managers, dealing with important issues facing Cisco's business, *i.e.*, demand for its products, product sales, orders, supply and inventory, as well as the design, testing and final pre-shipment validation of its new products, the manufacturing effectiveness and efficiencies of its products, and the quality of those products. Cisco maintained a system of internal controls that was organized and directed on a day-to-day basis under the supervision of Chambers, Cisco's CEO, and several executive, senior and ordinary vice presidents (collectively, the "Senior Officers").

(a) Chambers was at all relevant times Chief Executive Officer and a director.

(b) Carter was at all relevant times Senior Vice President-Finance and Administration, Chief Financial Officer, Secretary and a director of the Company.

(c) Daichendt was at all relevant times Executive Vice President-Worldwide Operations of the Company.

(d) Giancarlo was at all relevant times Senior Vice President-Small/Medium Business Line of Business of the Company.

(e) Mazzola was at all relevant times Senior Vice President-Enterprise Line of Business of the Company.

(f) Redfield was at all relevant times Senior Vice President-Manufacturing and Logistics of the Company.

(g) Volpi was at all relevant times Senior Vice President-Chief Strategy Officer of the Company.

(h) Estrin was, until 4/00, Chief Technology Officer of the Company.

13. Each of the Senior Officers, by virtue of their high-level positions with Cisco, directly participated in the management of Cisco, was directly involved in the day-to-day operations of Cisco at the highest levels and was privy to confidential proprietary information concerning Cisco and its business, operations, products, growth, financial statements and financial condition and was aware of or deliberately disregarded that the false and misleading statements were being made by and regarding the Company. Because of their managerial positions with Cisco, each of the Senior Officers had access to the adverse

undisclosed information about Cisco's business, products, financial condition and prospects and knew (or deliberately disregarded) that these adverse facts rendered the positive representations made during the Class Period materially false and misleading.

Financial Monitoring and Controls

14. Cisco's Senior Officers and directors closely monitored the performance of Cisco's business via financial reports which Cisco's Finance Department (under Carter) generated on a daily, weekly and monthly basis. There were "order reports" and "backlog reports" that summarized orders by dollar volume and product type, as well as unit "shipment" reports. The Finance Department also distributed monthly financial reports comparing Cisco's ***actual*** financial results to ***projected*** results. Thus, defendants knew the status of orders for and sales of ***every Cisco product*** so that they knew where Cisco stood in terms of the sale of and demand for its switching and routing products, as well as Cisco's actual financial results compared to budget. Thus, Cisco's top officers and directors were constantly aware of the current order rates for its products, as well as sales into and out of its distribution channel and its own direct sales. In fact, Cisco's computerized financial monitoring and reporting system is so sophisticated and refined that Cisco can "close its books" on a corporate-wide basis instantly, the so-called "real time" or "virtual" close. Cisco's top officers and directors, therefore, knew the rate of sales and order cancellations and prices for its products and demand for its products on a current basis and knew Cisco's revenues and profit/loss situation on a current basis. Thus, management of the Company knew that much of Cisco's sales growth was being generated by selling to companies who had been convinced to purchase Cisco product only through the granting of extremely liberal and excessive vendor financing and that some products were being shipped out incomplete or defective.

15. Cisco has an extremely sophisticated system of internal financial and accounting controls which operate under the supervision of Cisco's CFO Carter. The financial reporting system is so efficient that Cisco, in essence, is able to close its books instantly and is in a position to determine its quarterly revenues, profits and EPS to date instantly, at any time during the quarter, subject to non-recurring charges and adjustments. In fact, Cisco's top executives receive monthly financial statements for Cisco within a day or two after the close of a month that provide detailed financial information about revenues, profits and EPS on a company-wide basis and detailed sales data for each of Cisco's products in each of the geographic

regions where Cisco operates, as well as for its own direct sales. Also, Cisco's top executives received ***daily reports*** on product sales and product inventories that allowed them to monitor the demand for each of Cisco's products in all of its markets and all of its distribution channels. The use of Cisco Systems Capital to push sales was closely monitored as it was a crucial part of Cisco's entry into the telecom market.

Inventories of Finished Goods and Component Parts

16. Cisco's inventories of finished goods and component parts and its purchase commitments for components are three of the most vital parts of the operational aspects of Cisco's business. The accumulation of excessive finished goods or component parts inventory has an extremely negative impact on Cisco's profitability. Therefore, Cisco's top executives were fixated on the amount of finished goods inventory and on the status of Cisco's component part inventories on hand, as well as those that Cisco was committed to purchase.

17. In order to constantly and precisely monitor Cisco's inventories, Cisco tracked on a daily basis the precise amount of inventory of each type of product in the hands of each of its distributors and also monitored on a daily basis the sell-through of its products which, in turn, impacts channel inventories. Also, Cisco's top executives received daily reports of Cisco's finished goods inventories which were on hand at Cisco and knew precisely the amount of finished goods inventory on hand for each product. And, of course, they were able to monitor on a daily basis the precise sales of each product.

18. As a result of this sophisticated inventory monitoring system, Cisco's top executives knew as soon as demand began declining that retail sales were extremely weak for each of the products. Thus, Cisco's top executives realized that all of Cisco's new products were selling much more poorly than expected.

19. The slowdown in sales of Cisco products also created a crisis inside Cisco as early mid-2000, as Cisco's channel inventories began to balloon due to the slower than expected retail sell-through of new products as they were introduced. At the same time, the inventories of these products that Cisco had on hand also increased. As a result, ***Cisco's top executives knew that Cisco was accumulating millions and millions of dollars of excessive inventories***. This problem was exacerbated by the fact that much of the inventory which had been financed through Cisco Systems Capital to now-failing

companies who were then selling the equipment at liquidation prices, effectively competing with Cisco's sales at less than half the price, all of which was having a terribly negative impact on Cisco's revenues and EPS.

20. As Cisco's finished goods inventories ballooned, this created another very serious problem for Cisco, which its top executives were immediately aware of. Earlier in F00, in an effort to assure itself of a sufficient quantity of component parts to be able to manufacture its new products in quantity if the new products were successful, Cisco had entered into unusual purchase agreements with component parts suppliers which provided that ***Cisco would have to pay substantial financial penalties if it cancelled component parts orders***. Normally, a company of Cisco's size is such a desirable customer that it is able to obtain component parts without exposing itself to the risk of financial penalties upon cancellation. However, demand for certain components generally during the time period when Cisco was attempting to secure commitments to supply it with component parts for its new computers was so strong that component part manufacturers were able to force Cisco to agree to these unusual penalty terms. Thus, the slow sale of Cisco's products created a double-whammy. In addition to depriving Cisco of revenue needed to meet its revenue and EPS forecasts and causing its finished goods inventories to balloon, Cisco was now faced with the prospect of being overwhelmed by a tsunami of unneeded component parts which would, of course, further exacerbate its already seriously deteriorating inventory position.

Insider Stock Ownership and Sales

21. During the Class Period, Cisco's officers and directors owned huge amounts of Cisco stock and/or held millions of vested options to purchase Cisco stock. This huge equity stake gave Cisco's top officers and directors a very strong motive to do everything they could to keep Cisco's stock price up, including prematurely introducing new products without adequate pre-production and release testing and validation and lying about the actual state of development of Cisco's newest products and the current state of demand for Cisco's products – and thus Cisco's future financial results – all to help support Cisco's stock price. These top insiders did this because they knew that they faced little or no individual risk for such misconduct as, if they were caught and sued, they would be protected by the unusually huge amounts of directors' and officers' liability insurance Cisco maintains on its officers (purchased not with their funds, but rather with Cisco's stockholders' monies) and by Cisco's own assets (over $4 billion in cash), which they

would use to defend themselves and to settle any securities suits against them – with Cisco's and the insurance company's money, not their own.

22. During the Class Period, while defendants were continuing to issue false and misleading statements about Cisco, 13 of Cisco's Senior Officers and directors sold 10.8 million shares of their personally held Cisco stock between 8/99 and 11/00 for proceeds of at least $595 million. These Cisco Senior Officers and directors took the opportunity to sell significant amounts of their Cisco stock while in possession of materially adverse non-public information. The sales of Cisco stock include:

Name	**Shares**	**Proceeds**
Chambers	2,300,000	$151,512,500
Carter	2,634,400	$ 99,488,632
Daichendt	2,216,866	$109,623,109
Estrin	462,813	$ 48,448,097
Giancarlo	200,000	$ 12,700,000
Mazzola	140,624	$ 9,105,729
Redfield	1,110,000	$61,715,700
Volpi	390,000	$ 23,325,600
Bartz	60,400	$ 2,545,262
Gibbons	140,000	$ 7,304,542
Kozel	832,000	$ 44,538,860
West	170,000	$ 10,948,000
Puette	190,000	$ 14,124,500
TOTAL SALES	10,847,103	**$595,380,531**

23. The amounts of these stock sales are evidence that the sellers knew of the serious undisclosed conditions inside Cisco's business that were adversely impacting Cisco's business at that time and that they took advantage of that insider information. For instance:

(a) Cisco was artificially inflating its reported revenues, net income and EPS through a variety of accounting manipulations and tricks, including the following:

(i) Cisco was recording revenue on the sale of products to indirect customers where it had loaned 100% of the purchase price and which borrowers Cisco knew were not creditworthy and would likely never repay the loan made by Cisco in full;

(ii) Cisco was not adequately reserving for vendor financing loans it had made to uncreditworthy customers who Cisco knew would likely be unable to repay their loans from Cisco in whole or in part;

(iii) When making a vendor financed loan to a customer to purchase Cisco equipment, Cisco would require the buyer to purchase, through an intermediary such as a distributor or Cisco Value Added Partner ("VAP"), significant additional equipment the buyer did not need and did not want which Cisco knew would reduce demand for Cisco's products in the future; and

(iv) When certain products were in short supply at the end of a quarter, Cisco would ship shells of those products which did not contain internal working parts, telling the customer that they could return the shells and would receive the fully assembled working product in the following quarter. For example, in the 4thQ F99, Cisco shipped 14 switches to Worldwide Web in Miami, recognizing sales of approximately $400,000 each. When technicians tried to turn on the switches, they would not light up. They ultimately determined that Cisco had shipped only shells of the switches and the switches were not ready yet. Cisco agreed to replace the shells with actual switches in a subsequent quarter.

(b) Cisco's summa switch had substantial technical defects and quality problems which were resulting in significant and continued failure of this product in the field, which Cisco knew would require either replacement of the product or substantial remedial work at great expense; nevertheless, Cisco did not take any adequate reserve for this contingent liability and continued to ship what it knew were defective summa switches and record revenue on those shipments.

(c) Cisco's sales linearity was not as consistent or smooth as claimed as, in fact, Cisco was engaging in the above-detailed secret practices to boost Cisco's reported sales.

(d) Cisco's attempt to develop the optical switch it had acquired from Monterey Networks for $500 million in 9/99 was failing as, due to substantial continual technical difficulties with the product, Cisco could not successfully complete its development for commercial sale; as this was to be

Cisco's most expensive optical switch product, its failure to develop this product meant that Cisco would have extreme difficulty in successfully diversifying into the large telecom market.

(e) Many of Cisco's acquisitions were extremely disappointing, as products acquired were not yet functional and frequently engineers of acquired companies would leave for companies with better development support than Cisco. This left Cisco with incomplete products and without the qualified engineers to complete the products.

(f) Cisco had accumulated hundreds of millions of dollars worth of overvalued and excess inventory including inventory ordered under non-cancellable purchase commitments such that Cisco's earnings were materially overstated in violation of GAAP as described in ¶¶76-93.

(g) Cisco was selling defective products to competitive local exchange carrier ("CLEC") customers that Cisco knew would fail and would result in customers refusing to pay Cisco, leading to deteriorating future financial results.

(h) While Cisco was successfully entering the emerging carrier market leading to increased sales during the Class Period, this was the market in which customers could not pay for the product.

(i) Cisco's financial results were materially misstated and presented in violation of Generally Accepted Accounting Principles ("GAAP"), as described in ¶¶76-93, by selling excessive product to CLEC and service provider customers in exchange for extraordinary financing, failing to adequately accrue for bad debts and excess inventory and by shipping incomplete products.

Acquisition Binge/Dependency

24. Prior to the Class Period, Cisco completed many acquisitions to develop its product offerings. These acquisitions, while numerous, paled in comparison to the size of Cisco's Class Period purchases. Pre-Class Period purchases included the following:

Company (agreement date)

StratumOne Communications (6/99)
Transmedia Communications (6/99)
Amteva Technologies (4/99)
GeoTel Communications (4/99)
Sentient Networks (4/99)
Fibex Systems (4/99)
Pipelinks (12/98)
Selsius Systems (10/98)
Clarity Wireless (9/98)
Summa Four (7/98)

Price
$435 million
$407 million
$170 million
$ 2 billion
$125 million
$320 million
$118 million
$134 million
$153 million
$129 million

25. During the Class Period, Cisco acquired the following companies, issuing the following amount of Cisco stock:

Company Acquired	Date	No. Shares Issued	Value
Stratum One	9/99	13,300,000	$ 435,000,000
Monterey Networks	9/99	14,600,000	$ 500,000,000
Treas Media	9/99	13,900,000	$ 517,000,000
Cerent	11/99	200,000,000	$6,900,000,000
WebLine	11/99	8,600,000	$ 325,000,000
Pirelli	2/00	30,000,000	$2,081,000,000
Aironet	3/00	10,600,000	$ 835,000,000
SightPath, Inc.	5/00	11,400,000	$ 800,000,000
Atlantech Technologies	6/00	3,000,000	$ 179,000,000
JetCell	6//00	3,300,000	$ 203,000,000
Petacom, Ltd.	6/00	1,700,000	$ 102,000,000
InfoGear Technology	6/00	4,700,000	$ 301,000,000
ArrowPoint Communications, Inc.	6/00	90,200,000	$5,700,000,000
Qeyton Systems	7/00	14,300,000	$ 887,000,000
IP Mobile, Inc.	9/00	6,500,000	$ 422,000,000
Komodo Technologies	9/00	3,000,000	$ 184,000,000
Hynex, Ltd.	9/00	2,300,000	$ 129,000,000
Netiverse	10/00	3,200,000	$ 168,000,000

NuSpeed, Inc.	10/00	8,800,000	$ 463,000,000
IPCell Technologies	11/00	3,700,000	$ 213,000,000
Vovida Networks	11/00	5,200,000	$ 275,000,000
PixStream	12/00	4,900,000	$ 395,000,000
CAIS Software (part acquired)	12/00	Cash	$ 157,000,000
Radiata, Inc.	2/01	8,600,000	$ 266,000,000
Active Voice	2/01	5,900,000	$ 155,000,000

26. Cisco was utterly dependent upon making acquisitions to obtain needed technology, acquire engineering ability and boost its revenues and EPS. This was often commented upon by defendants and analysts following Cisco. For instance:

> Chambers: Now we will acquire 10 to 12 companies a year. Normally small companies acquiring next generation technology.
>
> * * *
>
> As it diversifies into fiber-optic communications gear and other new fields, Cisco continues to grow at an astonishing rate, exceeding 50% a year. It adds 1,000 employees a month and devours, on average, a high-tech start-up every two weeks.
>
> * * *
>
> Cisco to Continue Acquisitions. Cisco, which has already acquired stakes in 21 companies this year, indicated that it will continue to add new technologies to its portfolio because they believe, as do we, that it is easier and cheaper to acquire companies in down times when valuations come down a bit.
>
> * * *
>
> Acquisitions – Acquisitions are a core part of Cisco's growth strategy. Cisco completed five acquisitions in the quarter and reiterated its plan to buy 20-25 companies in this fiscal year, and at least 30 for fiscal 2001.
>
> * * *
>
> In order to grow at a rate faster than the market, we think Cisco has no choice but to turn to acquisitions for technology, products and headcount. The company has developed this strategy into an art form. In fact, giving Cisco the leeway to make acquisitions – which it does in a highly disciplined manner – is in fact a less risky prospect than simply waiting for the target company to fund its own growth and scale.
>
> * * *
>
> Cisco Systems CEO Chambers Says Acquisition Pace Won't Slow

> Cisco Systems Inc. Chief Executive John Chambers said a slumping market for computer networking stocks won't slow the No. 1 Internet equipment maker's acquisition strategy.
>
> "We are the white knight in many ways," Chambers said, speaking to a packed ballroom at the company's analyst meeting in San Jose, California.
>
> In his remarks, Chambers tried to emphasize that Cisco has an opportunity to "break away" from its competition. The company has made 22 acquisitions this year.
>
> * * *
>
> We believe that Cisco is likely to continue its strategy of growing through acquisition where necessary, however, the strategy will increasingly target companies in the earlier stages of their development. Cisco has one of the highest acquisition success rates in the industry, with more than 3 in 4 being successful and a similar percentage of CEO's staying on board after integration.

27. Another reason Cisco had to keep its stock price high was to create value in its stock options and thus help it recruit and retain hi-tech employees, which were in short supply in Silicon Valley. This effort was dependent on Cisco reporting favorable results.

BACKGROUND TO CLASS PERIOD

28. Cisco was incorporated in California in 1984 and shipped its first commercial multi-protocol router in 1986. Beginning in F94, Cisco began entering new markets and broadening its product offerings through a series of acquisitions. By the beginning of the Class Period, Cisco had grown from a company with annual sales of less than $2 billion in F95 to a company with sales exceeding $12 billion in F99. The acquisitions caused Cisco to be able to report enormous growth in sales and have its market capitalization increase from an already high $32 billion in 7/96 to $209 billion at the beginning of the Class Period.

29. However, this growth and acquisition binge also had negative characteristics. Many acquired products were not as fully developed as Cisco had expected. Cisco was not known as an engineering company and many engineers of acquired companies soon left after the acquisition due to general unhappiness with Cisco. This left Cisco with partially developed products but without the engineering know-how to complete the products.

30. By the beginning of the Class Period, Cisco was facing an additional challenge. To further its frenetic growth rate, Cisco was attempting to sell to the hottest part of the new economy – the Internet Service Providers ("ISPs") and, later, to smaller telecommunications companies, or CLECs. While these

companies offered enormous growth opportunities, they also suffered a problem common to start-ups – lack of capital. In the summer of 1999, competitive local service providers were entering into the multi-billion dollar local and long distance market by deploying new technology. What they lacked was capital. Cisco determined a way to use this to its advantage. Cisco Systems Capital would provide financing for these companies so long as they purchased Cisco product. Cisco used intermediaries such as distributors or Cisco VAPs, wherein ISPs and CLECs would buy Cisco products from distributors and Cisco VAPs and pay for the product using Cisco Systems Capital funding; the distributors and Cisco VAPs would then pay Cisco allowing Cisco to recognize revenue. This also gave Cisco leverage over these CLECs and ISPs to increase sales. This manipulation would permit Cisco to continue a trend it had developed of beating earnings expectations each quarter. The Cisco financing had several unique features for a financing agreement. Cisco would lend up to a third over the retail price of the equipment being sold such that loan amounts frequently exceeded the cost of the equipment to the customer by more than 100%. Payment terms were extremely liberal with terms as long as nine years and no payments due the first two years. Sales personnel were able to control or dictate the terms such that they could promise increased capital in exchange for a much needed order at quarter end or a larger sale than the customer desired. Moreover, requirements for credit could be waived such that millions of dollars in credit could be granted without so much as audited financial statements. Cisco utilized these unique financing characterizations to manipulate its sales. In fact, the ISPs and CLECs could not pay Cisco what they owed as they were poorly capitalized and in many cases working with non-functional Cisco equipment. Cisco also engaged in practices such as shipping incomplete product to make quarterly sales goals.

31. As the Class Period commenced, Cisco was preparing for the largest tech acquisition ever – Cerent for nearly $7 billion. It was essential Cisco report favorable financial results to continue its trend of beating forecasted levels of revenues and EPS so Cisco's stock would move higher.

FALSE AND MISLEADING STATEMENTS DURING THE CLASS PERIOD

32. On 8/10/99, Cisco reported its 4thQ and F99 year-end results in a press release which stated:

> Cisco Systems, Inc., the worldwide leader in networking for the Internet, today reported its fourth quarter and annual results for the period which ended on July 31, 1999.

Cisco closed its fiscal year with revenue of $12.15 billion, an increase of 43% over the previous year.

Net sales for the fourth quarter were $3.55 billion, compared with $2.40 billion for the same period last year, an increase of 48%. Pro forma net income, which excludes the write-off of purchased in-process R&D and acquisition-related costs discussed below, was $727 million or [$0.10] per share, compared with pro forma net income of $525 million or [$0.08] per share for the fourth quarter of 1998, increases of 38% and 31% respectively.

* * *

Net sales for fiscal 1999 were $12.15 billion, compared with $8.49 billion for the same period last year, an increase of 43%. Pro forma net income was $2.55 billion or [$0.38] per share, compared with pro forma net income of $1.88 billion or [$0.29] per share during fiscal 1998, increases of 35% and 29% respectively. Actual net income for fiscal 1999 was $2.10 billion or [$0.31] per share, versus actual net income of $1.35 billion or [$0.21] per share for the same period last year.

* * *

"The Internet is emerging as a major force behind the strongest U.S. economy in history," said John Chambers, president and CEO of Cisco Systems. "By providing the systems that make the Internet work, Cisco is playing a major role in helping customers thrive in the explosive Internet economy. ***As a result, we are growing faster than all of our key competitors and have been the fastest growing and most profitable company in the history of the computer industry***."

33. On 11/9/99, Cisco reported its 1stQ F00 results in a release which stated in part:

Net sales for the first quarter were $3.88 billion, compared with $2.60 billion for the same period last year, an increase of 49%. Pro forma net income, which excludes the write-off of purchased in-process R&D and the amortization of goodwill and purchased intangible assets, was $837 million or [$0.12] per share, compared with pro forma net income of $561 million or [$0.09] per share for the first quarter of 1999, increases of 49% and 41%, respectively.

* * *

Cisco entered the optical transport market with the acquisitions of Cerent Corporation and Monterey Networks, Inc., which were completed in November and October 1999, respectively. ***These acquisitions complement the strength of Cisco's optical switching solutions and give service providers an accelerated migration from old world circuit-based equipment to the New world of the Internet***.

34. Following these results, Cisco's stock increased to above $40 per share compared to approximately $30 at the beginning of the Class Period. In 11/99, Cisco acquired Cerent for 200 hundred million shares of Cisco stock.

35. On 2/8/00, Cisco reported ***better than expected*** 2ndQ F00 revenue, net income and EPS (the period ending 1/29/00), stating:

> Net sales for the second quarter of fiscal 2000 were $4.35 billion, compared with $2.85 billion for the same period last year, an increase of 53%. Pro forma net income ... was $906 million or [$0.13] per share, compared with pro forma net income of $609 million or [$0.18] per share for the second quarter of fiscal 1999, increases of 49% and 47%, respectively.

36. Following Cisco's 2/8/00 release and conference call and discussions with Chambers and Carter, virtually every analyst that followed Cisco ***increased the forecasted revenue, net income and EPS for Cisco and the price target for Cisco's stock***.

37. On 2/9/00, the *Los Angeles Times* reported:

> CISCO POSTS 49% JUMP IN PROFIT ... COMPUTER NETWORKER'S ROBUST RESULTS PUSH SHARES TO RECORD HIGH
>
> Cisco Systems said Tuesday that its fiscal second-quarter profit jumped a greater-than-expected 49%, showing again how the company has parlayed its dominance in providing the backbone of Internet and telecommunications networks ***into astonishing profit and revenue growth***.
>
> ***The news pushed Cisco shares to an all-time high in after-hours trading***.
>
> * * *
>
> "***Their underlying business is a lot stronger than people expected***," [Goldman, Sachs & Co. analyst Ajay] Diwan said.
>
> * * *
>
> ***Executives said that they expected sales to keep growing by as much as 30% to 50%*** ....

38. On 2/9/00, *The Wall Street Journal* reported:

> Cisco Systems Inc. reported ***unexpectedly strong fiscal second-quarter earnings amid astonishing revenue growth*** .... The results ... surpassed analysts' estimates ....
>
> "***We are increasingly optimistic***," Chief Financial Officer Larry Carter told Wall Street analysts.
>
> The results ignited a strong after-hours rally that pushed Cisco's market value above $450 billion ....
>
> * * *
>
> ... It marked the 11th consecutive quarter that Cisco had beaten analysts' expectations by exactly a penny....
>
> Revenue soared 53% to $4.35 billion from $2.85 billion in the year-earlier period. ***It marked the ninth consecutive quarter of accelerating revenue growth*** ....

> Revenue far exceeded analysts' estimates, which were clustered around $4 billion....
>
> "***This is stunning – far better than anyone was expecting***," said Christopher Stix, an analyst for SG Cowen & Co....
>
> "***Flawless***," echoed Michael Cristinziano of Gerard Klauer Mattison. Messrs. Cristinziano and Stix both described Cisco executives as "***giddy***" during their conference call with analysts.

39. By mid 2/00, Cisco's stock was trading above $65 per share, and defendants were in the midst of selling millions of their Cisco shares.

40. Each of the statements made between 8/99 and 2/00 was false or misleading when issued. The true but concealed facts were:

(a) Cisco was artificially inflating its reported revenues, net income and EPS through a variety of accounting manipulations and tricks, including the following:

(i) Cisco was recording revenue on the sale of products to indirect customers where it had loaned 100% of the purchase price and which borrowers Cisco knew were not creditworthy and would likely never repay the loan made by Cisco in full;

(ii) Cisco was not adequately reserving for vendor financing loans it had made to uncreditworthy customers who Cisco knew would likely be unable to repay their loans from Cisco in whole or in part;

(iii) When making a vendor financed loan to a customer to purchase Cisco equipment, Cisco would require the buyer to purchase, through an intermediary such as a distributor or Cisco VAP, significant additional equipment the buyer did not need and did not want which Cisco knew would reduce demand for Cisco's products in the future; and

(iv) When certain products were in short supply at the end of a quarter, Cisco would ship shells of those products which did not contain internal working parts, telling the customer that they could return the shells and would receive the fully assembled working product in the following quarter.

(b) Cisco's summa switch had substantial technical defects and quality problems which were resulting in significant and continued failure of this product in the field, which Cisco knew would require either replacement of the product or substantial remedial work at great expense; nevertheless, Cisco

did not take any adequate reserve for this contingent liability and continued to ship what it knew were defective summa switches and record revenue on those shipments.

(c) Cisco's sales linearity was not as consistent or smooth as claimed as, in fact, Cisco was engaging in the above-detailed secret practices to boost Cisco's reported sales.

(d) Cisco's attempt to develop the optical switch it had acquired from Monterey Networks for $500 million in 9/99 was failing as, due to substantial continual technical difficulties with the product, Cisco could not successfully complete its development for commercial sale; as this was to be Cisco's most expensive optical switch product, its failure to develop this product meant that Cisco would have extreme difficulty in successfully diversifying into the large telecom market.

(e) Many of Cisco's acquisitions were extremely disappointing, as products acquired were not yet functional and frequently engineers of acquired companies would leave for companies with better development support than Cisco. This would leave Cisco with incomplete products and without the qualified engineers to complete the products.

(f) Cisco was selling defective products to CLEC customers that Cisco knew would fail and would result in customers refusing to pay Cisco, leading to deteriorating future financial results.

(g) While Cisco was successfully entering the emerging carrier market leading to increased sales during the Class Period, this was the market in which customers could not pay for the product.

(h) Cisco's financial results were materially misstated and presented in violation of GAAP, as described in ¶¶76-93, by selling excessive product to CLEC and service provider customers in exchange for extraordinary financing, failing to adequately accrue for bad debts and excess inventory and by shipping incomplete products.

41. In early 5/00, a negative article about Cisco appeared in *Barron's* criticizing Cisco's acquisition binge, its accounting and its growing use of "vendor funding" to help sell its products. This caused Cisco's stock to decline and put pressure on Cisco's executives to continue to report favorable results.

42. On 5/9/00, Cisco reported ***better than expected*** 3rdQ F00 revenues, net income and EPS for the period ending 4/29/00, stating:

Net sales for the third quarter of fiscal 2000 were $4.92 billion, compared with $3.17 billion for the same period last year, an increase of 55%. Pro forma net income ... was $1.03 billion or $0.14 per share, compared with pro forma net income of $649 million or $0.09 per share for the third quarter of fiscal 1999, increases of 58% and 56%, respectively.

* * *

In the service provider marketplace, Cisco continued to advance its strategy for New World integrated data, voice, and video networks and made progress in all key areas. ***Cisco's New World solutions continued to gain acceptance from incumbent carriers worldwide, underscoring the trend toward the Internet as the platform for all future telecommunications***....

Cisco also continues to gain momentum in the IP + optical market furthering its commitment to build Internet-scale, carrier-class, optical networks. Strengthening its product portfolio, Cisco introduced the Cisco 10000 Edge Services Router (ESR), a carrier-class product for Internet service providers (ISPs) deploying high-density dedicated-access IP services. The Cisco 10000 ESR is based on a groundbreaking technology, Parallel eXpress Forwarding architecture, developed internally to enable networks to maintain consistent high performance while adding advanced New World services.

43. On 5/10/00, *The Wall Street Journal* reported:

Cisco Continues Its Strong Run As Sales Soar

Cisco Systems Inc. continued to break new ground by ***growing at a rate rarely seen in a large global company***.

For the 10th time in a row, the ... company reported accelerating revenue growth .... Fiscal third-quarter revenue climbed 55% from a year earlier, up from the 53% rate for its fiscal second quarter.... ***[O]nce again, Cisco posted earnings on operations a penny a share higher than analysts had predicted – the 12th consecutive quarter it has beat forecasts by exactly one cent***.

Cisco executives continued to be upbeat about their prospects....

44. On 5/10/00, the *Los Angeles Times* reported:

Cisco Tops Expectations for 9th Straight Quarter

Defying concerns it cannot sustain its string of quarterly profits, Internet equipment provider Cisco Systems Inc. topped Wall Street expectations for the ninth consecutive period on strong sales of equipment for routing Web and data traffic.

* * *

... Cisco earned $1.03 billion, or 14 cents a share, in the latest quarter ....

As has been the pattern, Cisco's earnings exceeded expectations by a penny a share. Analysts ... had expected the company to earn 13 cents a share, excluding charges.

Sales rose 55% to $4.92 billion from $3.17 billion a year ago, also topping Wall Street expectations.

* * *

"Given our size and the fact that the third-quarter has historically been the most challenging quarter, ***we were very pleased with the results***," Chambers said.

45. On 8/8/00, Cisco reported ***better than expected*** 4thQF00 and F00 revenues, net income and EPS (for the period ending 7/29/00) via a release stating:

Net sales for the fourth quarter of fiscal 2000 were $5.72 billion, compared with $3.56 billion for the same period last year, an increase of 61%. Pro forma net income ... was $1.20 billion or $0.16 per share for the fourth quarter of fiscal 2000, compared with pro forma net income of $710 million or $0.10 per share for the fourth quarter of fiscal 1999, increases of 69% and 60%, respectively.

* * *

Net sales for fiscal 2000 were $18.93 billion, compared with $12.17 billion for fiscal 1999, an increase of 55%. Pro forma net income was $3.91 billion or $0.53 per share for fiscal 2000, compared with pro forma net income of $2.52 billion or $0.36 per share for fiscal 1999, increases of 56% and 47%, respectively.

* * *

... "***We were very pleased with the balance of our business across all key geographies, products, and lines of business***," [said John Chambers, president and CEO of Cisco Systems].

46. On 8/9/00, *The Wall Street Journal* reported:

Strong Cisco Revenue Surprises Analysts

Cisco Systems Inc. defied skeptics with another quarter of exceptional growth ... [and] surprised analysts with its 11th consecutive quarter of accelerating revenue growth. Cisco said revenue for the fiscal fourth quarter ended July 29 leapt 61% to $5.72 billion from $3.56 billion a year earlier.

That is a growth rate more common among start-ups than $19 billion-a-year behemoths such as Cisco. But Cisco is perfectly positioned to take advantage of the explosive growth of the Internet and has been strengthening its stranglehold over large businesses' computer networks.

"***We have executed beyond even our own stretch goals***," Chief Executive John Chambers told Wall Street analysts.... ***Mr. Chambers said he was "more bullish" than usual about Cisco's prospects, and now expects revenue to grow close to 50% in the fiscal year that started last week***.

Cisco also narrowly exceeded analysts' expectations for earnings per share. But that was hardly news: It marked the 13th consecutive quarter Cisco topped the Wall Street consensus by exactly one penny.

* * *

The results come amid a period of unusual investor uncertainty about Cisco, whose highflying stock has doubled, on average, every year since it went public in 1990.

47. On 8/9/00, the *Los Angeles Times* reported:

Cisco Tops forecast as Sales Surge 61%

Cisco Systems Inc. on Tuesday reported fiscal fourth-quarter profit that topped expectations, paced by strong sales to Internet service providers and cable and telephone companies.

* * *

Cisco Chief Executive John Chambers said that sales were balanced across all geographic regions where it sells its wares, and across all its lines of business.

"***Given our size, we're very pleased with our results***," Chambers said in a conference call to discuss the results. "***We see more opportunities in the combined video, voice and data markets than we can meet***."

48. Each of the statements made between 2/00 and 8/00 were false or misleading when issued. The true but concealed facts were:

(a) Cisco was artificially inflating its reported revenues, net income and EPS through a variety of accounting manipulations and tricks, including the following:

(i) Cisco was recording revenue on the sale of products to indirect customers where it had loaned 100% of the purchase price and which borrowers Cisco knew were not creditworthy and would likely never repay the loan made by Cisco in full;

(ii) Cisco was not adequately reserving for vendor financing loans it had made to uncreditworthy customers who Cisco knew would likely be unable to repay their loans from Cisco in whole or in part;

(iii) When making a vendor financed loan to a customer to purchase Cisco equipment, Cisco would require the buyer to purchase, through an intermediary such as a distributor or Cisco VAP, significant additional equipment the buyer did not need and did not want which Cisco knew would reduce demand for Cisco's products in the future; and

(iv) When certain products were in short supply at the end of a quarter, Cisco would ship shells of those products which did not contain internal working parts, telling the customer that they could return the shells and would receive the fully assembled working product in the following quarter.

(b) Cisco's summa switch had substantial technical defects and quality problems which were resulting in significant and continued failure of this product in the field, which Cisco knew would require either replacement of the product or substantial remedial work at great expense; nevertheless, Cisco did not take any adequate reserve for this contingent liability and continued to ship what it knew were defective summa switches and record revenue on those shipments.

(c) Cisco's sales linearity was not as consistent or smooth as claimed as, in fact, Cisco was engaging in the above-detailed secret practices to boost Cisco's reported sales.

(d) Cisco's attempt to develop the optical switch it had acquired from Monterey Networks for $500 million in 9/99 was failing as, due to substantial continual technical difficulties with the product, Cisco could not successfully complete its development for commercial sale; as this was to be Cisco's most expensive optical switch product, its failure to develop this product meant that Cisco would have extreme difficulty in successfully diversifying into the large telecom market.

(e) Many of Cisco's acquisitions were extremely disappointing, as products acquired were not yet functional and frequently engineers of acquired companies would leave for companies with better development support than Cisco. This would leave Cisco with incomplete products and without the qualified engineers to complete the products.

(f) Cisco had accumulated hundreds of millions of dollars worth of overvalued and excess inventory, including inventory ordered under non-cancellable purchase commitments such that Cisco's earnings were materially overstated in violation of GAAP as described in ¶¶76-93.

(g) Cisco was selling defective products to CLEC customers that Cisco knew would fail and would result in customers refusing to pay Cisco, leading to deteriorating future financial results.

(h) While Cisco was successfully entering the emerging carrier market leading to increased sales during the Class Period, this was the market in which customers could not pay for the product.

(i) Cisco's financial results were materially misstated and presented in violation of GAAP, as described in ¶¶76-93, by selling excessive product to CLEC and service provider customers in exchange for extraordinary financing, failing to adequately accrue for bad debts and excess inventory and by shipping incomplete products.

49. In late 8/00-early 9/00, Cisco's stock began to decline due to increasing concerns among investors over a possible slowdown in capital expenditures among telecom service providers during 2001. Over the next several weeks, Cisco repeatedly assured investors that it was not seeing any slowdown in orders or demand for its products and would continue to post very strong revenue and EPS growth.

50. Cisco was to report its 1stQ F01 results (the quarter ended 10/28/00) on 11/6/00. Due to the growing concern over a capital expenditures slowdown by telecom service providers in 2001 and the poor performance of Cisco's stock in 8/00-10/00, investors were especially interested in this report and Cisco's commentary on its business.

51. For instance, on 11/3/00, a major article about Cisco appeared in *The Wall Street Journal*, headlined and stating:

> SUPERSTAR'S PACE: CISCO KEEPS GROWING, BUT EXACTLY HOW FAST IS BECOMING AN ISSUE; AS DEBATE OVER ITS STOCK MOUNTS, THE OUTCOME COULD HAVE BIG RIPPLES
>
> Every three months for the past two years, John Chambers, chief executive of Cisco Systems Inc., has told Wall Street analysts that Cisco's revenue can grow 30% to 50% a year in a healthy economy.
>
> Just as routinely, analysts and investors largely ignored Mr. Chambers' statements as too conservative. The economy was plenty healthy, after all, and Cisco was growing faster than his target – at a 61% annual clip in its most recently reported quarter.
>
> But now, for the first time in years, there is serious debate about how fast Cisco can grow. Telecommunications companies, which have accounted for a disproportionate share of Cisco's growth in recent years, are curbing their budgets for new equipment. Some telecom start-ups are running out of money. Dot-coms are vanishing, and with them some purchases of Cisco gear. The economy is showing signs of slowing, which could curtail spending by big businesses, Cisco's core customers.
>
> The result: Many investors are starting to take Mr. Chambers literally. Some are trimming projections for Cisco's long-term revenue growth to around 40% a year.
>
> * * *
>
> ***The difference between revenue growth of 50% and 40% may not sound like much, but it's crucial for tech investors, who place a premium on growth***.

* * *

> Cisco executives remain extraordinarily bullish as well, though they are reluctant to discuss specifics in advance of Monday's earnings report. "***We haven't seen any sign of a slowdown," says Michelangelo Volpi, chief strategy officer. He says Cisco has made no changes to its internal plans since the beginning of its fiscal year in August. "We have guided the Street accurately, and we can execute to plan***."

* * *

> Corporate sales this year "***have surprised even us***," Cisco's Mr. Volpi says.

* * *

> ***Cisco won't feel the worst effects of that slowdown, because it doesn't make any of the telephone equipment whose sales are dropping***.

* * *

> There's another wild card: Cisco could acquire technology to tap a new market and fuel additional growth. Indeed, acquisitions account for much of Cisco's growth since 1993....
>
> Historically, Cisco has been able to acquire the technology it wanted in part because its stock kept rising. A flat or falling stock makes acquisitions tougher, by reducing the shares' allure to entrepreneurs and by increasing the dilution to existing shareholders. "The stock price is the currency with which they fund their research and development," says Walter Casey, co-manager of the technology portfolio for Banc One Investment Advisors. "If they have trouble using the stock to make acquisitions, that would be a big deal for them."
>
> So far, that hasn't seemed to be an issue. Mr. Volpi notes that entrepreneurs frequently weigh competing offers, and stumbles by rivals have made Cisco's stock more attractive by comparison. "***We haven't even talked about adjusting our acquisition strategy***," he says.

52. Cisco stock fell from $70 on 8/9/00 to $58-1/8 on 9/12/00 to $49-1/4 on 10/12/00, and $45-1/4 on 10/30/00. This hurt the value of options and made it more difficult to retain employees. The decline also jeopardized acquisitions, as with a lower stock price Cisco would have to issue more shares to make the acquisitions. Defendants knew they had to convince the market that other tech companies' problems were not affecting it and its earnings would continue to grow.

53. On 11/6/00, Cisco issued a release reporting its 1stQ F01 results, stating:

> Cisco Systems, Inc., the worldwide leader in networking for the Internet, today reported its first quarter results for the period ending October 28, 2000.
>
> Net sales for the first quarter of fiscal 2001 were $6.52 billion, compared with $3.92 billion for the same period last year, an increase of 66%. Pro forma net income, which excludes the effects of acquisition charges, payroll tax on stock option exercises, and net gains realized on minority investments, was $1.36 billion or $0.18 per share for the

first quarter of fiscal 2001, compared with pro forma net income of $814 million or $0.11 per share for the first quarter of fiscal 2000, increases of 67% and 64%, respectively.

54. On 11/7/00, *The Wall Street Journal* reported:

In a conference call with Wall Street analysts, Cisco executives said they remained as optimistic as ever. "We continue to see more opportunity than we're able to fund," said Chief Executive John Chambers.

Indeed, Chief Financial Officer Larry Carter urged analysts to increase their estimates for revenue and earnings for the fiscal year ending next July. Mr. Carter said Cisco expects fiscal-year revenue to grow 50% to 60%, faster than its traditional guidance of 30% to 50% growth. He urged analysts, who now expect Cisco to earn 72 cents to 75 cents a share for the year, to raise those estimates by two cents to five cents a share.

* * *

... ***Chief Financial Officer Larry Carter said Cisco had sharply increased the amount of revenue it deferred from sales through resellers or Cisco's financing arm, suggesting continued strong revenue growth ahead***.

* * *

Still, Mr. Chambers said Cisco had been able to avoid the missteps of its competitors and other tech giants because of its unusually diverse customer base. Bookings from big companies, small companies and telecommunications carriers each grew more than 50% annually, as did bookings in each major geographic area.

"***It is this balance that dramatically differentiates us from all our competitors***," Mr. Chambers said.

* * *

Inventories grew far faster than sales, climbing 59% to $1.96 billion, from $1.23 billion on July 29. Cisco officials said they had stockpiled some components to guard against potential shortages, and built up inventories of finished products to reduce lead times, which had stretched beyond three months in recent months. Mr. Carter told analysts that Cisco would maintain higher levels of inventory for at least another three months.

55. The 11/27/00 edition of *Fortune* contained an article on Chambers, stating:

JOHN CHAMBERS, 51, is CEO of Cisco Systems.

We just showed in our latest quarterly results that growth is accelerating at Cisco. Our problems are still managing growth. ***Yes, the trouble with dot-coms has certainly hurt us, but it has been offset by increases by our enterprise customers. Also, geographically, when one piece weakens, other stronger pieces make up for it. As for the Wall Street analysts, well, the mood now is to ignore the nine positive things and focus on the one area of concern. For us that was inventories. We want to reduce our inventory because we want to reduce the cycle time to our customers. That's it***.

56. On 12/1/00, the following ran on *Bloomberg*:

Cisco Systems Inc., the world's largest maker of Internet equipment, expects its Asian sales for the fiscal years ending July 2001 ***to grow faster than elsewhere, as phone companies in the region spend more on networking products***.

The region accounted for about 10 percent of Cisco's revenue in the fiscal year ended July 31 and grew by an average of 80 percent in the past two years as against 50 percent in the U.S.

"***In Asia, we continue to see very aggressive numbers***," said Gary Jackson, vice-president of the San Jose, California-based company's Asian operations in an interview. "***Asia is our fastest growing piece of business***."

57. Despite Cisco's bullish presentation after releasing it 1stQ F01 results and at the Tech 2000 Conference, Cisco's stock continued to fall in price – declining from $57-5/8 on 11/7/00 to as low as $45-3/16 on 11/30/00.

58. On 12/2/00, the following ran on *Bloomberg*:

Cisco Expected to Give Upbeat Presentations at Analyst Meeting

Cisco Systems Inc. Chief Executive John Chambers and other top officials likely will give upbeat presentations at the company's analyst meeting Monday and Tuesday, analysts said.

* * *

Investors will listen for hints as to whether Cisco's business of selling equipment to telecommunications equipment is recovering, said Tom Lauria, an analyst at ING Barings ....

Orders in that business for the quarter ended Oct. 28 increased from the previous quarter by a percentage in the "high single digits," while revenue rose 15 percent. Chambers said last month he "***would be surprised and disappointed***" if the order rate doesn't return to double digits this quarter.

"If they can show people that they are on target for that, I think that will really help them a lot," Lauria said.

When Cisco reported fiscal first-quarter results on Nov. 6, Chief Financial Officer Larry Carter ***said the company expects fiscal 2001 revenue to grow 50 percent to 60 percent. Fiscal second-quarter revenue will rise from the first by a percentage in the "high single" or "low double" digits***, he said.

59. On 12/4/00, *Bloomberg* reported:

Cisco Systems CEO Chambers Says Acquisition Pace Won't Slow

Cisco Systems Inc. Chief Executive John Chambers said a slumping market for computer networking stocks won't slow the No. 1 Internet equipment maker's acquisition strategy.

"We are the white knight in many ways," Chambers said, speaking to a packed ballroom at the company's analyst meeting in San Jose, California.

In his remarks, Chambers tried to emphasize that Cisco has an opportunity to "break away" from its competition. The company has made 22 acquisitions this year.

Chambers also took pains to spell out that the company was not changing its financial forecasts in any way.

Before the meeting began, investors speculated that the company might surprise analysts with lower forecasts. That proved to be unfounded.

"***We aren't changing guidance, nor should you interpret any comment as changing guidance***," Chambers said.

60. On 12/5/00, *The Wall Street Journal* reported:

Cisco Holds to Bullish Growth Projections Despite Cloudy Skies for Tech Industry

Cisco Systems Inc. reaffirmed its bullish projections of rapid growth, despite ... new economic clouds.

"***I have never been more optimistic***," said John Chambers, Cisco's chief executive, before roughly 500 analysts at a Cisco-sponsored conference in San Jose, Calif. "***There are no changes to the guidance***."

That guidance to analysts a month ago indicated that Cisco's revenues will increase about 10% for the current fiscal quarter ending in January, as compared with the preceding quarter, and will rise more than 50% for the fiscal year ending July....

Cisco's health is a closely watched barometer for the technology industry. Mr. Chambers, in a 75-minute speech, parried a series of questions about potential threats to its growth. A slowing economy? Economic growth of 2% to 3% next year is "fine," he said.

Reductions in capital spending by businesses? "We are not immune," Mr. Chambers said, "but we will not be affected as much as others." Corporate leaders now believe that the Internet is changing their businesses and will "spend money in good times and bad," he said.

* * *

The "law of large numbers," which makes it progressively hard for $20 billion-a-year titans such as Cisco to keep growing at the same rate? "***The size of a company does not affect your ability to grow***," Mr. Chambers said. "***Our challenge is more what markets we don't go into than which ones we do go into***."

61. On 12/5/00, *USA Today* reported:

Cisco CEO Reassures As Concerns About Growth Percolate

Despite the stock-market swoon and a slowing economy, ***Cisco Systems CEO John Chambers told analysts Monday that the networking behemoth would dominate more new markets, keep buying companies and continue its strong yearly revenue growth of 50% or more***.

* * *

> ***Chambers said any downturn could be good for Cisco as companies try to cut costs and increase productivity by upgrading their computer networks***.
>
> He boldly predicted that Cisco would rule several new technology markets over the next three to five years, including the lucrative telecommunications-equipment field led by Lucent Technologies and Nortel Networks. Cisco already controls a No. 1 or No. 2 market share in more than a dozen product areas for computer-networking equipment.
>
> Chambers also said that Cisco would keep surging into Asia, Europe and Latin America, which are starving for technology. Cisco's growth rates in countries abroad already are running about 50% a year.

62. Cisco's stock jumped from $45 on 12/4/00 to $53-9/16 on 12/6/00, a market capitalization increase of over $56 billion.

63. Each of the statements made between 8/00 and 12/00 were false or misleading when issued. The true but concealed facts were:

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did not take any adequate reserve for this contingent liability and continued to ship what it knew were defective summa switches and record revenue on those shipments.

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(e) Many of Cisco's acquisitions were extremely disappointing, as products acquired were not yet functional and frequently engineers of acquired companies would leave for companies with better development support than Cisco. This would leave Cisco with incomplete products and without the qualified engineers to complete the products.

(f) Cisco had accumulated hundreds of millions of dollars worth of overvalued and excess inventory, including inventory ordered under non-cancellable purchase commitments such that Cisco's earnings were materially overstated in violation of GAAP as described in ¶¶76-93.

(g) Cisco was selling defective products to CLEC customers that Cisco knew would fail and would result in customers refusing to pay Cisco, leading to deteriorating future financial results.

(h) While Cisco was successfully entering the emerging carrier market leading to increased sales during the Class Period, this was the market in which customers could not pay for the product.

(i) Cisco's financial results were materially misstated and presented in violation of GAAP, as described in ¶¶76-93, by selling excessive product to CLEC and service provider customers in exchange for extraordinary financing, failing to adequately accrue for bad debts and excess inventory and by shipping incomplete products.

64. On 12/12-13/00, ***Cisco revealed in an SEC filing that it had established a $275 million reserve for uncollectible accounts receivables and over-valued/excessive inventories –***

much larger than anticipated or earlier disclosed. On 12/15/00, *Bloomberg* widely publicized this filing, reporting that:

> CISCO RAISES LOSS RESERVES TO $275 MLN IN 1ST QUARTER
>
> Cisco Systems Inc., the biggest computer networking equipment maker, set aside $275 million during its first fiscal quarter to cover losses from unpaid customer bills and other items, ***more than tripling the amount earmarked a year earlier***.
>
> The bigger loss reserve, reported in a quarterly filing with the Securities and Exchange Commission, reinforces concerns by some analysts that Cisco and other equipment makers, such as Nortel Networks Corp. and Lucent Technologies Inc., could suffer because of cash shortages at telecommunications carriers and Internet service provides on which they rely for sales.
>
> * * *
>
> LOSS RESERVES GROW WITH SALES
>
> ***Claudia Ceniceros, a Cisco spokeswoman, said the reserve covers losses on inventories, investments and accounts receivable. She said these losses increased because Cisco is doing more business than last year***, while declining to specify how much of the reserve pertains to the various categories.
>
> Inventories at Cisco rose to $1.95 billion at Oct. 28 compared to $1.23 billion at July 29. Cisco in its quarterly filing said customers that account "for a significant proportion of our sales" generally have a right to return inventory or get credits if prices change.
>
> * * *
>
> ***The company had discussed the reserve during its first quarter conference call with analysts, Ceniceros said. Analysts say the company warned that loss provisions would grow without providing specific numbers***.
>
> * * *
>
> Creditworthiness Concern
>
> "***It certainly just raises the issue again of the creditworthiness of their customers***," said Walter Casey, an analyst with Banc One Investment Advisors, which owns Cisco shares. "***It's a concern – no question about it***."
>
> * * *
>
> Cisco faces challenges because it increasingly relies on sales to service providers, such as long-distance carriers to Internet access providers and wireless companies, which now provide 40 percent of its sales. In the past, the company got most of its business from what it calls enterprises, or large corporate clients.
>
> Financing Sales
>
> Many telephone carriers require their suppliers to provide financing for purchases. Cisco, Nortel, Lucent and other suppliers provide credit to generate business and keep sales growing.

"They are very large companies and they have some pretty significant requirements" for meeting sales growth targets, Seth Spaulding, an analyst at Epoch Partners, said of Cisco and Nortel. "They would have pressure to ship to" telecommunications carriers "that don't have the best ability to pay."

In particular, financial woes have increased among Internet service providers and telecommunications carriers who compete with the regional Bells to provide local telephone service. ICG Communications Inc., in filing for bankruptcy protection last month, said it owed Cisco almost $18 million.

65. These larger reserves indicated to investors and analysts that Cisco's vendor financing activities, in fact, contained substantial losses and that Cisco had over-valued and excessive inventories. As a result, Cisco stock fell from $55-1/4 on 12/13/00 to $35-5/32 on 12/21/00, losing over $150 billion in market capitalization in just six trading days on volume of over 650 million shares.

66. However, Cisco continued to assure investors and analysts that demand for its products remained strong and that Cisco's revenues and EPS would continue to show the previously forecasted levels of growth during the balance of F01 and F02.

67. On 1/30/01, *Bloomberg News* reported:

Cisco's Chambers Lowers Forecast, Avoids Sell-off

Cisco Systems Inc. Chief Executive John Chambers has made several public appearances in what appears to be a move to reduce expectations for the company without openly admitting as much, *The Wall Street Journal* reported in its "Heard on the Street" column.

During one recent appearance, Chambers signaled concern about Cisco's growth forecast for the fiscal year. Although he never explicitly told analysts to reduce estimates, at least 10 did exactly that, the paper said. Chambers said that analysts are "reading to much into" his statements, while repeating his uncertainty about the company's outlook, the paper said.

The tactic can be effective in a volatile market, where missing estimates by a penny can provoke a stock sell-off, the paper said. Chambers has been successful in reducing expectations, and the shares are little changed from before he began making his public remarks, the paper said.

68. On 1/31/01, Chambers was quoted in a *Bloomberg* report as follows:

Cisco CEO Chambers on Hiring, Sales Outlook; Company Comment

John Chambers, chief executive of Cisco Systems Inc., comments on Cisco's hiring plans, acquisition strategy, and the outlook for sales and its optical networks business. Chambers talked with reporters after he spoke to the Swiss-American Chamber of Commerce in Zurich:

On whether parts of Cisco have a hiring freeze:

"I don't have a hiring freeze on the company as a whole, but we are very selective about where we are hiring."

* * *

On Cisco's sales outlook:

"Capital spending will determine how much opportunity we have. If you tell me what capital spending will be by country, I can tell you exactly what our sales will be. It's just that in the U.S. you have service providers slowing their capital spending dramatically and the question is, how long does that last? And enterprise customers are starting to slow – so far not a big effect on Cisco, but an effect. So it depends on how this occurs."

"I'm looking for wider variations. Before you could predict what our earnings were going to be within a penny or two, because it is easy to do when there is consistent trend. Now we honestly don't know as accurately, so I expect a wider range in Q1 and Q2."

"I still see growth rates of 30 to 50 percent per year in the segment of the information technology industry where we are involved – the network. IT in and of itself is not where the productivity occurs. Network applications is where the leverage occurs."

69. Each of the statements made between 12/00 and 1/01 were false or misleading when issued. The true but concealed facts were:

(a) Cisco was artificially inflating its reported revenues, net income and EPS through a variety of accounting manipulations and tricks, including the following:

(i) Cisco was recording revenue on the sale of products to indirect customers where it had loaned 100% of the purchase price and which borrowers Cisco knew were not creditworthy and would likely never repay the loan made by Cisco in full;

(ii) Cisco was not adequately reserving for vendor financing loans it had made to uncreditworthy customers who Cisco knew would likely be unable to repay their loans from Cisco in whole or in part;

(iii) When making a vendor financed loan to a customer to purchase Cisco equipment, Cisco would require the buyer to purchase, through an intermediary such as a distributor or Cisco VAP, significant additional equipment the buyer did not need and did not want which Cisco knew would reduce demand for Cisco's products in the future; and

(iv) When certain products were in short supply at the end of a quarter, Cisco would ship shells of those products which did not contain internal working parts, telling the customer that they could return the shells and would receive the fully assembled working product in the following quarter.

For example, in the 4thQ F99, Cisco shipped 14 switches to Worldwide Web in Miami, recognizing sales of approximately $400,000 each. When technicians tried to turn on the switches, they would not light up. They ultimately determined that Cisco had shipped only shells of the switches and the switches were not ready yet. Cisco agreed to replace the shells with actual switches in a subsequent quarter.

(b) Cisco's summa switch had substantial technical defects and quality problems which were resulting in significant and continued failure of this product in the field, which Cisco knew would require either replacement of the product or substantial remedial work at great expense; nevertheless, Cisco did not take any adequate reserve for this contingent liability and continued to ship what it knew were defective summa switches and record revenue on those shipments.

(c) Cisco's sales linearity was not as consistent or smooth as claimed as, in fact, Cisco was engaging in the above-detailed secret practices to boost Cisco's reported sales.

(d) Cisco's attempt to develop the optical switch it had acquired from Monterey Networks for $500 million in 9/99 was failing as, due to substantial continual technical difficulties with the product, Cisco could not successfully complete its development for commercial sale; as this was to be Cisco's most expensive optical switch product, its failure to develop this product meant that Cisco would have extreme difficulty in successfully diversifying into the large telecom market.

(e) Many of Cisco's acquisitions were extremely disappointing, as products acquired were not yet functional and frequently engineers of acquired companies would leave for companies with better development support than Cisco. This would leave Cisco with incomplete products and without the qualified engineers to complete the products.

(f) Cisco had accumulated hundreds of millions of dollars worth of overvalued and excess inventory, including inventory ordered under non-cancellable purchase commitments such that Cisco's earnings were materially overstated in violation of GAAP as described in ¶¶76-93.

(g) Cisco was selling defective products to CLEC customers that Cisco knew would fail and would result in customers refusing to pay Cisco, leading to deteriorating future financial results.

(h) While Cisco was successfully entering the emerging carrier market leading to increased sales during the Class Period, this was the market in which customers could not pay for the product.

(i) Cisco's financial results were materially misstated and presented in violation of GAAP, as described in ¶¶76-93, by selling excessive product to CLEC and service provider customers in exchange for extraordinary financing, failing to adequately accrue for bad debts and excess inventory and by shipping incomplete products.

70. On 2/6/01, Cisco reported its 2ndQ F01 results with EPS of $.18 – $1.01 ***below*** forecasted levels, on revenues well below forecasted levels – revenue growth of just 3.5% – the lowest quarter-over-quarter revenue growth in Cisco's history as a public company. Cisco's inventory soared by $600 million in the 2ndQ – doubling in just months to $25 billion. Cisco also revealed it had imposed a hiring freeze and cut back sharply on new financing commitments by Cisco Systems Capital. Cisco also revealed that its accounts receivable had also soared – growing much faster than sales – and that its 3rdQ F01 revenues would decline from 2ndQ F01 levels – which would be the first quarter-over-quarter revenue decline in Cisco's history as a public company. Cisco's stock plunged on these revelations – falling from $36-3/16 to $29-7/8, a 17% drop on trading volume of 279 million shares – the second largest one-day trading volume in the history of the United States securities markets – a wipe-out of over $42 billion in Cisco's market capitalization. As a result, analysts slashed revenue and EPS forecasts for Cisco.

71. Analysts and investors were furious over the deception that had been practice by Cisco, as the following comments show:

- *Bloomberg*, 2/6/01:

> "They missed the top line. They missed the bottom line. The guidance was horrible," said Ed Dowd, an analyst at Independence Investment Associates, which owns about 13 million Cisco shares. "I don't feel comfortable about anything."

- *The New York Times*, 2/7/01:

> Cisco, which has had 44 consecutive quarters of revenue growth, shocked the financial analysts that follow the company by saying today that it expected revenue to decline in the next quarter by as much as 5 percent.
>
> "I've followed the company since it went public, and I've never seen a down sequential revenue quarter," said Paul Johnson, a financial analyst at Robertson Stephens. "That took me by surprise."
>
> * * *
>
> "The numbers are worse than we had expected, that's clearly a cause for concern," said Michael Ching, a financial analyst at Merrill Lynch. "We are going to need to recalibrate for the April quarter on this lower base."

• *Washington Post*, 2/7/01:

Steve Kamman, an executive director at CIBC World Markets who recently downgraded Cisco shares from "buy" to "hold," said the results were even worse than his lowered estimates based on warnings the company had given earlier about a tough market.

"They have a clockwork-like regularity when it comes to warnings – they always do well – and that's why everyone had so much confidence in the company. I think this news points to some very bad times ahead," he said.

• *The Wall Street Journal*, 2/7/01:

The speed of the reversal in Cisco's fortunes is startling. As recently as November, Cisco urged analysts to increase their financial targets for the current fiscal year. Then, in two January speeches, Mr. Chambers said Cisco's business had slowed significantly in mid-December. Many analysts trimmed their forecasts for the remainder of the fiscal year, but few anticipated yesterday's results.

In response, Cisco has imposed a hiring freeze, cut discretionary spending and slowed new commitments by its financing arm. Still, Cisco added more than 4,000 employees, to 43,000 in the second quarter, and expects to add as many as 2,000 in the current quarter, from commitments made months ago.

The rising payroll and rising inventory prompted some analysts to question how well Cisco is reacting to the slowdown. "I was shocked by the inventory," said Nikos Theodosopoulos of UBS Warburg.

• Sanford Bernstein & Co., 2/7/01:

* Cisco delivered surprisingly poor 2Q01 results ... disappointing on revenue – $6.754B vs. $6.9B, gross margins – 61.8% vs. 62.7%, accounts receivable – 47 DSO vs. 40 in 1Q, and inventories – 4.6 turns vs. 6.0 in 1Q. Furthermore, Cisco gave stark guidance for the remaining two quarters of FY01, confirming very weak capital spending in North America and parts of Europe.

* * *

* Cisco missed consensus EPS for the first time in its history, breaking a 14-quarter streak of beating by exactly a penny. There is evidence that Cisco stretched mightily even to reach $0.18. The 7-day increase in receivables DSOs suggests significant business closed in the last days of the quarter. Other income was up 20% QoQ when cash balances were done $1.6 Billion ....

* * *

* Inventory days on hand have almost doubled YoY to 79, the result of over-optimistic business projections and long-term supply agreements. Cisco suggests inventory levels will get worse before they get better, taking 3 quarters to reach target levels. This will bring down gross margins until the situation is resolved. It also increases risk of inventory obsolescence.

72. During the balance of 2/01 and during 3/01, Cisco continued to reveal further substantial problems with its business, including:

- Laying off some 8,000 workers – 17% of Cisco's workforce – resulting in a $300-$400 million charge.
- Cisco had taken a $195 million inventory charge in the 2ndQ F01.
- Cisco was halting its acquisition program and had not acquired a single company since 12/00.
- Cisco was abandoning its most expensive optical networking product – the Monterey ONS 15900 series wave length router, which it had paid $500 million for in 9/99 because the product had never been successfully developed for commercial use.
- Cisco's 3rdQ F01 EPS would decline from its 3rdQ F00 EPS and its 2ndQ F01 EPS.

73. Then, after the close of the markets on 4/16/01, Cisco announced a huge shortfall in 3rdQ F01 revenues, $1.2 billion in restructuring charges and $2.5 billion in inventory write-downs, equivalent to 90% of the inventory on the Company's books, at 1/31/01. The release stated:

> Due to continued global economic challenges, the slowdown in the global telecom market, and the deceleration in corporate IT spending, Cisco expects revenue for its fiscal third quarter to be down approximately 30 percent sequentially from fiscal second quarter, which was $6.7 billion. The Company expects to be profitable for the third quarter, with pro-forma earnings per share expected to be in the very low, single-digit range. As global economies and capital spending inevitably turn around, the Company's long-term expectations for its segment of the IT industry remain at 30 to 50 percent growth per year.
>
> * * *
>
> "Personally, of all the difficult decisions we've had to make, the toughest was the reductions in headcount," said Chambers. Cisco expects to take a restructuring charge of approximately $800 million to $1.2 billion during the fiscal third quarter, associated with the restructuring of certain areas of Cisco's business.
>
> This charge comprises the following three components:
>
> - Workforce reduction charge- Cisco is reducing its workforce by approximately 8500 people, which includes 2500 temporary and contract workers. Cisco expects to take a one-time charge of approximately $300 to 400 million this quarter related to this reduction in workforce. When the reduction in headcount is fully implemented, Cisco believes these actions will reduce its overall cost structure by approximately $1 billion on an annualized basis. Initial savings will begin during the fiscal fourth quarter of 2001.
> - Consolidation of excess facilities and related fixed assets charge- Due to the workforce reduction and restructuring of certain businesses, Cisco expects to consolidate its workforce into designated facilities, resulting in an excess facilities charge of approximately $300 to $500 million.
> - Asset impairment charge- The restructuring of certain businesses will also result in a charge relating to the impairment of assets, primarily goodwill, of approximately $200 to $300 million.

> Cisco also expects to take an additional excess inventory charge of approximately $2.5 billion during its fiscal third quarter.
>
> * * *
>
> Cisco continues to see capital spending and macro-economic challenges expanding into other regions of the world. The United States continues to be challenging, especially in the enterprise and service provider areas of business. In Asia Pacific, Cisco is seeing weakness in Korea, Taiwan, Australia, and Japan. In Europe, Cisco is also experiencing weakness, primarily in the service provider market and in segments of the enterprise business.
>
> The Company currently expects its fiscal fourth quarter revenue will range from flat to down 10 percent sequentially. Cisco stated that visibility going forward is more difficult in the current business climate and is subject to more variability than normal.

74. On a subsequent conference call, Cisco also disclosed that it would do fewer vendor financing deals in future quarters.

75. As these negative revelations continued, Cisco's stock continued to plummet, falling to as low as $13-1/2. Cisco stock has fallen from a Class Period high of $82, meaning its market capitalization has fallen from $555 billion to under $100 billion – a wipe-out of some $450 billion for Cisco's public shareholders. However, Cisco's insiders named as defendants did not do nearly so poorly. During the Class Period, they sold 10.8 million shares of their Cisco stock, pocketing $595 million in illegal insider trading proceeds.

CISCO'S FALSE FINANCIAL STATEMENTS

76. In order to inflate the price of Cisco stock, defendants caused the Company to falsely report its results for at least the 4th99, 1stQ, 2ndQ, 3rdQ and 4thQ F00 and the 1stQ and 2ndQ F01 through improper revenue recognition, including recognizing as sales the shipment of shell units of products not yet developed, manipulating revenue on financing arrangements with certain of its indirect customers, including CLECs, and failing to adequately accrue for bad debts, thereby materially overstating its revenue and net income during the Class Period. Ultimately, Cisco admitted that its results for F01 would be adversely affected due to a deterioration in the economy and it has become apparent that Cisco will have to record large charges to account for the inability of many of its customers to pay the amounts owed. Cisco has also recorded an unprecedented charge of $2.5 billion to write down overvalued inventory. In fact, much of Cisco's growth reported during the Class Period was due to its practice of using Cisco

Systems Capital to lend money to non-creditworthy customers to buy Cisco product, which practice it can no longer continue and is contributing to its poorer than expected results.

77. Cisco reported the following results during the Class Period (before charges for purchased research and development, payroll tax on stock option exercises, and gains realized on minority investments):

	4THQ F99 7/31/99	1STQ F00 10/31/99	2NDQ F00 1/29/00	3RDQ F00 4/29/00	4THQ F00 7/29/00	1STQ F01 10/28/00	2NDQ F01 1/27/01
Revenue	$3.56B	$3.88B	$4.35B	$4.32B	$5.72B	$6.52B	$6.75B
Net Income	$727M	$837M	$906M	$1.03B	$1.20B	$1.36B	$1.33B
EPS	$ 0.10	$ 0.12	$ 0.13	$ 0.14	$ 0.16	$ 0.18	$ 0.18

78. Cisco included its 4thQ F99 and 4thQ F00 results in Form 10-Ks which were filed with the SEC. The Form 10-Ks were signed by Chambers and Carter. The interim results were included in Form 10-Qs signed by Carter and filed with the SEC. The Form 10-Qs represented that as to the accompanying financial statements, "[i]n the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present a fair statement of financial position" and "results of operations ... have been made."

79. These representations were false and misleading when made, as Cisco's financial statements for the 4thQ F99, 1stQ, 2ndQ, 3rdQ and 4thQ F00 and the 1stQ and 2ndQ F01 were not a fair presentation of Cisco's results and were presented in violation of GAAP and SEC rules.

80. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. SEC Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC which are not prepared in compliance with GAAP are presumed to be misleading and inaccurate, despite footnote or other disclosure. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosure which would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. §210.10-01(a).

81. The Individual Defendants caused Cisco to falsify its reported financial results through its improper revenue recognition on Cisco's transactions involving Cisco Systems Capital in which Cisco Systems Capital would extend loans to indirect customers to buy Cisco products. The indirect customers

were then directed to buy excessive amounts of Cisco products through Cisco's VAPs. The indirect customers would pay for the product to the VAP or distributor, who would in turn pay Cisco. Cisco would then record sales with 80%+ margins as revenue. However, in fact, Cisco was just recycling its own cash. Moreover, many of Cisco's sales were not valid as it was frequently shipping non-functioning units to customers who were left with too much product, much of which did not work. As a result, these borrowers could not and would not repay their loans to Cisco.

82. These loans were extended even where the customers did not meet Cisco's very minimal loan covenants. These loans actually were granted in amounts way beyond the amounts customers needed to acquire Cisco products, as many customers were granted financing well in excess of the purchase price as incentive to purchase Cisco products. One reason customers were granted such liberal payment terms and such terms were used to extract additional orders from the customers was that often customers were granted more than one-third of the retail price as additional financing so long as they would agree to purchase the product. The customers, including many ISPs and CLECs were start-ups and unable to pay back even the invoice amounts. Thus, the extension of additional credit was extremely risky. Moreover, the revenue reported was not indicative of demand for Cisco's products but rather due to the financing scheme. Cisco granted its sales personnel authority to grant credit and extend payment terms (Cisco Systems Capital personnel acquiesced to sales personnel) so as to accelerate sales and income reporting. Pursuant to GAAP, Cisco should have deferred recognition of revenue on such shipments, but did not in order to inflate its reported results. Moreover, pursuant to GAAP, Cisco was required to adequately accrue losses for uncollectible accounts receivable, but did not in order to report growing EPS during the Class Period.

83. GAAP, as set forth in FASB Statement of Financial Accounting Standard ("SFAS") No. 5, Accounting for Contingencies, requires that the estimated portion of uncollectible accounts receivable be accrued in the period it becomes evident that receivables or some portion of the receivables will not be collected. SFAS No. 5, ¶22 states in part:

> Losses from uncollectible receivables shall be accrued when both conditions in paragraph 8 [it is probable that an asset has been impaired and the amount of loss can be reasonably estimated] are met. Those conditions may be considered in relation to individual receivables or in relation to groups of similar types of receivables. If the conditions are

> met, accrual shall be made even though the particular receivables that are uncollectible may not be identifiable.

84. Despite knowing that certain of its CLEC customers did not meet Cisco Systems Capital's required loan covenants, Cisco extended credit to the customers so that Cisco could make sales and improperly recognize the revenue and then failed to adequately accrue losses for uncollectible receivables in order to inflate its reported results, contrary to GAAP. One of these CLEC customers was American Metricomm ("AMC") which was essentially insolvent at the time Cisco started dealing with it. Other problematic customers included Digital Broadband, HarvardNet, PSINet and Vectris. In the last six months, numerous CLECs have filed for bankruptcy, all of which used Cisco products. This is resulting in non-payment and a flood of Cisco products hitting the market at bargain prices.

85. GAAP, as described by FASB Statement of Concepts ("Concepts") No. 5 provides that the recognition of revenue should occur only where two fundamental conditions are met: the revenue has been earned and the amount is collectible. Concepts No. 5, ¶¶83-84.

86. In fact, during the Class Period, Cisco had not earned revenue it recognized as it failed to ship working units to some customers. Cisco would send shell products so that revenue could be recognized and then the products could be exchanged for functional units in later quarters. In the summer of 1999, Cisco shipped 14 switches to Worldwide Web in Miami, recognizing sales of approximately $400,000 each. When technicians tried to turn on the switches, they would not light up. They ultimately determined that Cisco had shipped only shells of the switches and the switches were not ready yet. Cisco agreed to replace the shells with actual switches in a subsequent quarter.

87. Unfortunately for investors, Cisco's results, and the representations concerning them, were false. Ultimately, Cisco's results have been adversely affected by its customers having financial problems, including bankruptcy. As the *Financial Times* reported on 4/3/01:

> On Tuesday PSINet, one of the oldest internet access providers in the US and a prominent customer of Cisco, warned it was likely to face bankruptcy and delisting from the Nasdaq after a sharp fall in business.
>
> Other internet and telecom providers are thought to be on the brink of such announcements in the next few weeks.

* * *

> Although Cisco's vendor financing deals are thought to be significantly lower than its largest competitors, including Lucent and Nortel, it is nevertheless expected to take write-offs as bankruptcies mount.

88. The *Financial Times* also reported on 4/4/01:

> Several companies in which Cisco has almost $200 million in cumulative financing commitments – including Digital Broadband, HarvardNet and Vectris – have recently gone bankrupt, releasing millions of dollars worth of Cisco equipment into the used equipment auction market.
>
> "Cisco's equipment is being auctioned off at 10 to 20 per cent of its catalogue price," says Matt Sousa, an equipment reseller on the East Coast. "Cisco is effectively competing against itself at prices it cannot possibly match."
>
> * * *
>
> The company's equity exposure to private companies has also increased sharply. For example, "minority investments" in non-listed companies have risen more than fivefold to $765 million in the past 12 months. These investments are recorded at cost and do not reflect the collapse in valuations in recent months.
>
> "Cisco has been acting as a banker to its customers and it will pay a price for that," says Jack Whelan, at Fechtor Detwiler, a brokerage firm in Boston.
>
> A brief tour of Cisco's website illustrates the zeal with which the group has been pursuing customers. It offers support on "terms which mean less documentation than traditional bank financing," and which offer "off-balance sheet financing."
>
> Customers need only need two years of financial statements ("auditing is preferred"). In addition, "Cisco Capital can tailor your financing to include equipment obtained from sources other than Cisco."

89. GAAP, as set forth in Accounting Research Bulletin ("ARB") No. 43, Chapter 4, Statement No. 5, states:

> A departure from the cost basis of pricing the inventory is required when the utility of the goods is no longer as great as its cost. Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical deterioration, obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly designated as ***market***.

90. During the Class Period, Cisco failed to adequately accrue for excess and obsolete inventory, including inventory ordered under non-cancellable purchase orders. Cisco's inventory has grown faster than sales leading to excessive inventory. The ratio of inventory turns shows the growth in inventory relative to sales on a quarterly basis. Note the following:

4/25/98	7/25/98	10/24/98	1/23/99	5/1/99
2.44	2.26	2.38	2.09	1.77

7/31/99	10/30/99	1/29/00	4/29/00	7/29/00	10/28/00
1.93	2.08	2.21	1.99	1.68	1.22

91. Ultimately, due to its rapidly deteriorating sales, Cisco has been forced to record a write-down of inventory to reflect the deterioration in the value of its inventory. The amount of the write-down ($2.5 billion) exceeds one-third of all the net income Cisco reported during the Class Period.

92. Due to these accounting improprieties, the Company presented its financial results and statements in a manner which violated GAAP, including the following fundamental accounting principles:

(a) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements (APB No. 28, ¶10);

(b) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB Statement of Concepts No. 1, ¶34);

(c) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events and circumstances that change resources and claims to those resources was violated (FASB Statement of Concepts No. 1, ¶40);

(d) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB Statement of Concepts No. 1, ¶50);

(e) The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB Statement of Concepts No. 1, ¶42);

(f) The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);

(g) The principle of completeness, which means that nothing is left out of the information that may be necessary to insure that it validly represents underlying events and conditions was violated (FASB Statement of Concepts No. 2, ¶79); and

(h) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶95, 97).

93. Further, the undisclosed adverse information concealed by defendants during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information which is expected to be and must be disclosed.

DEFENDANTS' INSIDER TRADING

94. During the Class Period defendants sold the following amount of their Cisco stock despite adverse information about Cisco's business which they knew had not been disclosed to the public:

Insider	Date	Shares	Price	$ Value
Bartz	8/16/99	400	$31.65	$ 12,662
	8/19/99	40,000	$31.25	$ 1,250,000
	8/14/00	20,000	$64.13	$ 1,282,600
		60,400		$ 2,545,262
Carter	8/13/99	284,400	$31.53	$ 8,967,132
	8/16/99	200,000	$32.02	$ 6,404,000
	8/17/99	150,000	$32.00	$ 4,800,000
	8/18/99	500,000	$31.93	$ 15,965,000
	8/19/99	500,000	$31.105	$ 15,552,500
	8/19/99	500,000	$31.93	$ 15,965,000
	8/17/00	300,000	$63.45	$ 19,035,000
	8/18/00	200,000	$64.00	$ 12,800,000
		2,634,400		$ 99,488,632
Chambers	2/11/00	2,300,000	$65.875	$151,512,500
		2,300,000		$151,512,500

Daichendt	8/13/99	100,000	$31.25	$ 3,125,000
	8/13/99	49,874	$31.22	$ 1,557,066
	8/13/99	55,126	$31.315	$ 1,726,271
	8/13/99	50,000	$31.28	$ 1,564,000
	8/13/99	13,308	$32.815	$ 436,702
	8/13/99	22,372	$31.22	$ 698,454
	8/13/99	100,000	$31.22	$ 3,122,000
	8/13/99	126	$31.22	$ 3,934
	8/13/99	97,628	$31.22	$ 3,047,946
	8/13/99	120,000	$31.28	$ 3,753,600
	8/13/99	104,064	$31.25	$ 3,252,000
	8/13/99	143,436	$31.25	$ 4,482,375
	8/13/99	112,500	$31.25	$ 3,515,625
	2/11/00	61,288	$66.500	$ 4,075,652
	2/14/00	140,626	$64.605	$ 9,085,143
	2/14/00	150,000	$64.605	$ 9,690,750
	2/14/00	84,378	$64.605	$ 5,451,241
	2/14/00	34,340	$64.605	$ 2,218,536
	2/14/00	66,656	$64.605	$ 4,306,311
	8/11/00	140,625	$62.590	$ 8,801,719
	8/11/00	213,332	$62.590	$ 13,352,450
	8/11/00	25,000	$62.590	$ 1,564,750
	8/11/00	47,812	$62.590	$ 2,992,553
	8/11/00	150,000	$62.590	$ 9,388,500
	8/11/00	50,000	$62.590	$ 3,129,500
	8/11/00	84,375	$62.590	$ 5,281,031
		2,216,866		$109,623,109
Estrin	8/13/99	80,000	$31.23	$ 2,498,000
	11/12/99	50,000	$41.84	$ 2,092,000
	2/11/00	332,813	$65.890	$ 43,858,097
		462,813		$ 48,448,097
Gibbons	8/20/99	48,600	$30.875	$ 1,500,525
	8/20/99	1,400	$30.905	$ 43,267
	2/17/00	10,000	$64.315	$ 643,150
	2/17/00	40,000	$64.35	$ 2,574,000
	8/18/00	40,000	$63.59	$ 2,543,600
		140,000		$ 7,304,542
Giancarlo	8/18/00	200,000	$63.500	$ 12,700,000
		200,000		$ 12,700,000
Kozel	8/13/99	40,000	$31.25	$ 1,250,000
	8/13/99	80,000	$31.375	$ 2,510,000
	8/13/99	30,000	$31.50	$ 945,000
	8/13/99	120,000	$31.315	$ 3,757,800
	2/17/00	40,000	$64.325	$ 2,573,000
	2/17/00	40,000	$64.33	$ 2,573,200
	2/17/00	40,000	$64.00	$ 2,560,000
	2/17/00	40,000	$64.745	$ 2,589,800
	2/17/00	40,000	$64.485	$ 2,579,400
	2/17/00	40,000	$64.55	$ 2,582,000
	8/11/00	50,000	$64.00	$ 3,200,000
	8/11/00	50,000	$64.50	$ 3,225,000

	8/14/00	20,000	$63.76	$ 1,275,200
	8/14/00	10,000	$63.71	$ 637,100
	8/14/00	20,000	$63.67	$ 1,273,400
	8/14/00	10,000	$63.94	$ 639,400
	8/14/00	40,000	$63.63	$ 2,545,200
	8/14/00	50,000	$64.25	$ 3,212,500
	8/14/00	50,000	$64.00	$ 3,200,000
	8/18/00	22,000	$64.13	$ 1,410,860
		832,000		$ 44,538,860
Mazzola	2/14/00	5,000	$66.220	$ 331,100
	2/17/00	80,000	$64.690	$ 5,175,200
	2/18/00	55,624	$64.710	$ 3,599,429
		140,624		$ 9,105,729
Puette	3/21/00	30,000	$70.00	$ 2,100,000
	3/21/00	20,000	$70.13	$ 1,402,600
	3/21/00	30,000	$70.06	$ 2,101,800
	3/21/00	30,000	$70.03	$ 2,100,900
	3/24/00	60,000	$80.24	$ 4,814,400
	3/24/00	20,000	$80.24	$ 1,604,800
		190,000		$ 14,124,500
Redfield	8/13/99	50,000	$31.22	$ 1,561,000
	8/13/99	50,000	$31.75	$ 1,587,500
	8/17/99	50,000	$31.795	$ 1,589,750
	8/18/99	20,000	$32.00	$ 640,000
	8/18/99	30,000	$32.00	$ 960,000
	8/19/99	100,000	$31.095	$ 3,109,500
	2/17/00	490,000	$64.815	$ 31,759,350
	8/11/00	155,000	$64.440	$ 9,988,200
	8/18/00	165,000	$63.760	$ 10,520,400
		1,110,000		$ 61,715,700
Volpi	8/11/00	3,750	$64.500	$ 241,875
	8/11/00	562	$64.500	$ 36,249
	8/11/00	75,688	$64.500	$ 4,881,876
	8/18/00	137,688	$64.000	$ 8,812,032
	8/18/00	32,312	$64.000	$ 2,067,968
	11/28/00	140,000	$52.040	$ 7,285,600
		390,000		$ 23,325,600
West	2/11/00	10,000	$65.655	$ 656,550
	2/11/00	45,000	$65.655	$ 2,954,475
	2/11/00	45,000	$65.785	$ 2,960,325
	8/11/00	45,000	$62.07	$ 2,793,150
	8/14/00	25,000	$63.34	$ 1,583,500
		170,000		$ 10,948,000
TOTAL:		10,847,103		$595,380,531

CLASS ACTION ALLEGATIONS

95. This is a class action on behalf of purchasers of Cisco common stock between 8/10/99 and 2/6/01, excluding defendants (the "Class"). Excluded from the Class are officers and directors of the Company, as well as their families and the families of the defendants. Class members are so numerous that joinder of them is impracticable.

96. Common questions of law and fact predominate and include whether defendants: (i) violated the 1934 Act; (ii) omitted and/or misrepresented material facts; (iii) knew or recklessly disregarded that their statements were false; and (iv) artificially inflated Cisco's stock price and the extent of and appropriate measure of damages.

97. Plaintiff's claims are typical of those of the Class. Prosecution of individual actions would create a risk of inconsistent adjudications. Plaintiff will adequately protect the interests of the Class. A class action is superior to other available methods for the fair and efficient adjudication of this controversy.

CLAIM FOR RELIEF

98. Defendants violated §10(b) and Rule 10b-5 by:

(a) Employing devices, schemes and artifices to defraud;

(b) Making untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and

(c) Engaging in acts, practices and a course of business that operated as a fraud or deceit upon the Class in connection with their purchases of Cisco stock.

99. Class members were damaged as they paid artificially inflated prices for Cisco common stock in reliance on the integrity of the market.

PRAYER

WHEREFORE, plaintiff, on behalf of itself and the Class, prays for judgment as follows:

A. Declaring this action to be a class action properly maintained pursuant to Rule 23 of the Federal Rules of Civil Procedure;

B. Awarding plaintiff and other members of the Class damages together with interest thereon;

C. Awarding plaintiff and other members of the Class costs and expenses of this litigation, including reasonable attorneys' fees, accountants' fees and experts' fees and other costs and disbursements; and

D. Awarding plaintiff and other members of the Class such equitable/injunctive or other and further relief as may be just and proper under the circumstances.

JURY DEMAND

Plaintiff demands a trial by jury.

DATED: April 20, 2001

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CERTIFICATION OF INTERESTED ENTITIES OR PERSONS

Pursuant to Civil L.R. 3-16, the undersigned certifies that as of this date, other than the named parties, there is no such interest to report.

ATTORNEY OF RECORD FOR
PLAINTIFF PLUMBERS & PIPEFITTERS
LOCAL 572 PENSION FUND

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